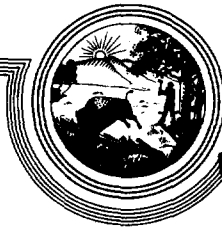


STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION
302 W. WASHINGTON STREET, ROOM E306
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VIA FEDERAL EXPRESS

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: In the Matter of Simplification of the Depreciation
Prescription Process, CC Docket No. 92-296

Dear Ms. Searcy:

Enclosed please find an original and nine copies of Comments of the Indiana Utility Regulatory Commission. An extra copy is also enclosed with a stamped self-addressed envelope; please date stamp and return.

Copies of these comments have also been sent to the Downtown Copy Center and the Accounting and Audits Division. Please contact me should you have any questions concerning this matter.

Sincerely,

A handwritten signature in cursive script, appearing to read "Jerry Webb".

Jerry Webb
Chief Engineer

Enclosures

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**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)

Simplification of the)
Depreciation Prescription)
Process)

CC Docket No. 92-296

FCC MAIL ROOM

**Comments of the
Indiana Utility Regulatory Commission**

On December 29, 1992, the Federal Communications Commission (FCC) released a Notice of Proposed Rulemaking (NPRM) in the aforementioned captioned docket seeking comments from interested parties on simplification of the depreciation prescription process. The FCC seeks comment on proposals to simplify the procedures and reduce the associated cost of the depreciation prescription process. Comments are to be filed on or before March 10, 1993; reply comments are due on or before April 13, 1993.

The Indiana Utility Regulatory Commission (IURC) hereby respectfully submits its comments in this matter. The IURC is the state regulatory body charged with regulating investor-owned telecommunications carriers in Indiana. Pursuant to Indiana Code 8-1-2-19, the IURC is required "from time to time" to "ascertain and determine the proper and adequate rates of depreciation of the several classes of property of each public utility."

I. Introduction

In this NPRM, the FCC states that it continues its efforts to reduce unnecessary regulatory burdens and the associated costs by simplification of the depreciation prescription process. Currently, the FCC prescribes depreciation rates by plant account

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for individual carriers. Generally, rates are prescribed on a triennial basis. The IURC has been a consistent participant in this triennial process and has worked diligently with the FCC in the development of depreciation rates for Indiana's FCC jurisdictional companies. In this NPRM, the FCC seeks comment on its proposals that would simplify the depreciation process and reduce administrative costs. The IURC herein comments on the FCC's depreciation simplification proposals.

II. Background

A. The Depreciation Process

As defined by the FCC, depreciation is the process of allocating the cost of plant over its service life. (NPRM, at para 2). Pursuant to statutory mandate, the FCC prescribes depreciation rates for American Telephone and Telegraph (AT&T), Alascom, Inc., and 33 local exchange carriers (LECs).

Depreciation rates are calculated by the FCC using the remaining life formula that follows:

depreciation rate =

$$\frac{(100\% - \text{accumulated depreciation}\% - \text{future net salvage})}{\text{average remaining life}}$$

Both the future net salvage (FNS) and the average remaining life (ARL) must be estimated. FNS is the estimated gross salvage less the estimated cost of removal and the ARL is the average of future life expectancy of investment in a particular plant account. The ARL is composed of two components: the projection life or the life expectancy of new additions of plant and the survivor curve or the retirement distribution of plant. In turn, these two basic factors are used to develop the future life expectancy of the investment at each vintage in the plant account and a composite of these expected lives result in an ARL. (NPRM, at para 4).

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Once all parameters are developed, a depreciation rate is computed. The carriers then apply the depreciation rate to the average plant account balance to calculate the depreciation expense.

Because the basic parameters, ARL, projection life, survivor curve, and FNS, are estimates, detailed analyses to support these parameters are necessary.

B. Need for Simplification

The FCC states that the current prescription process was developed in the 1940's and has been refined throughout the years. However, the telephone industry has experienced significant change since that time, including competition in many markets and rapidly changing technology. In response to these changes, the FCC put into place price cap regulation. The price cap plan encourages carrier efficiency without allowing depreciation expense to be passed on to ratepayers. The telephone industry has estimated that completing depreciation studies as currently prescribed costs \$35-\$50 million industry-wide. Because of these high cost estimates, the FCC has issued this rulemaking. (NPRM, at para 7 & para 8). The IURC applauds the timely efforts of the FCC in introducing this NPRM.

III. Discussion

The FCC has proposed four options for simplification of the current depreciation process: the basic factor range option, the range of rates option, the depreciation schedule option, and the price cap option.

A. Basic Factor Range Option

1. Definition

The basic factor range option continues to use the remaining life formula to determine depreciation rates. Basically, it would establish ranges for the essential parameters of the remaining

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life formula, i.e., FNS and ARL, specifically, the projection life and survivor curve parameters which are necessary to determine the ARL. This option would eliminate the need for detailed support justifying the proposed parameters, provided the parameters selected fall within established ranges. (NPRM, at para 9 & para 13).

2. Recommendation

The IURC supports the use of this option for the determination of depreciation rates. It is a simple and accurate method for determining depreciation rates. The basic factor range option retains the use of the remaining life formula which incorporates both the accumulated depreciation and the ARL for a particular account. This effectively allows for the true-up of any accumulated depreciation imbalance caused by past over or under depreciation accruals which resulted from prior over or under life and salvage estimates. This true-up mechanism essentially eliminates the need for amortizations of reserve imbalances. Additionally, it provides the carriers with greater flexibility than in the past, while reducing the administrative burden of justifying company proposed depreciation parameters.

3. Implementation of the Basic Factor Range Option

The IURC agrees with the FCC that industry-wide data should be used initially to determine the ranges, including a statistical analysis of the basic factors underlying the currently prescribed rates. Additionally, the IURC supports a range of plus or minus one standard deviation from the mean. This would typically encompass approximately 70% of the data points.

The FCC has tentatively concluded that separate basic factor ranges should be established for the 33 LECs and the two IXCs. The IURC agrees with this conclusion because of the competitive, technological, and regulatory diversity of these two types of carriers.

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The IURC contends that the FCC should establish basic factor ranges for all plant accounts at the same time. While there may be instances where some plant accounts are not easily adapted to this methodology, we believe that those exceptions are best handled on a case-by-case basis rather than across the board. The problem we note, if the ranges are phased-in over a period of time, is that this approach may penalize some carriers which find the basic factor range option especially advantageous. Additionally, phasing-in this option by plant account further erodes the anticipated or alleged administrative cost savings.

The IURC agrees with the FCC that this option should be mandatory for all carriers on all applicable accounts. Additionally, we agree with the FCC that this option provides carriers great flexibility in the prescription of their depreciation rates. Therefore, the IURC contends that in instances where the carriers' currently prescribed depreciation rates fall outside of the available basic factor ranges, the carriers should have to show cause as to why a waiver should be granted exempting them from using the established basic factor ranges. Further, the IURC agrees with the FCC that the implementation of ranges should be staggered and should correspond to the carriers' triennial represcription period. Finally, the IURC believes that carriers should only be allowed to update their depreciation rates during the triennial review.

B. The Range of Rates Option

The range of rates option establishes a range of depreciation rates for each plant account. The remaining life rate formula would no longer be used in this option. (NPRM, at para 26)

While this option would be very simple to use, the IURC strongly objects to it because it lacks a true-up mechanism and could create reserve imbalances. The IURC is a strong proponent of depreciation methodologies that result in the matching of costs

to the cost causer. This option, because of the lack of a true-up mechanism, could cause potentially large intergenerational inequalities between ratepayers. Based on the aforementioned reasons the IURC cannot support this option.

C. The Depreciation Schedule Option

1. Definition

In this option, the FCC would establish a depreciation schedule based on average service life, retirement pattern, and salvage value by account. (NPRM, at para 33).

2. Recommendation

This option provides complete asset recovery; however, it deviates in matching cost recovery with consumption, thereby, creating intergenerational inequalities. Additionally, this option also raises concerns about the treatment of embedded plant. Since the schedule is designed to recover 100% of the investment over the service life, adjustments may be needed from time to time because of the embedded plant already depreciated.

The IURC finds this option unduly complicated because of the embedded plant issue. Further, the IURC cannot support this option because of matching issues and potential reserve imbalances.

D. The Price Cap Carriers Option

1. Definition

The price cap carriers have argued that, because of the endogenous treatment of depreciation expense, they should not be subject to the current depreciation prescription process. The carriers contend that changes in depreciation expenses do not affect rates and, therefore, detailed depreciation analysis is unnecessary. Under the current LEC price cap scheme, the LECs must share earnings with their customers if the earnings fall within a specified zone. (NPRM, at para 40).

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Under this option the carriers would be required to file their current rates, proposed rates, and the changes in the depreciation expense once the proposed rates become effective. The FCC would no longer analyze the carriers' rates nor would the carriers be required to file extensive supporting documentation. (NPRM, at para 41).

2. Recommendation

While the IURC agrees that this appears to be the least burdensome and, perhaps, the most cost efficient option, it is also the most worrisome. We agree with Commissioner Duggan's assessment of this option. Depreciation is the single largest expense for a telephone utility and depreciation expense is not a measurable out-of-pocket cost. Rather, it is an estimate of the rate at which an asset loses its value over time. Furthermore, simply "rubber-stamping" the depreciation rates is not appropriate and is in direct conflict with the FCC's obligation to Section 220(b) of the Communications Act.

As Commissioner Duggan points out, even for carriers under price caps, presubscribing accurate depreciation rates is necessary. While changes in the depreciation expense may not directly affect the price cap index, such expenses may affect the sharing zone. The sharing zone is where carriers are obliged to share excess earnings with customers through future price cap reductions. Therefore, carriers have an incentive to manipulate depreciation expenses in order to avoid the sharing obligation. Due to the aforementioned reasons the IURC strongly objects to this option.

IV. Conclusion

In summary, the IURC commends the FCC on its timely issuance of this NPRM and its goal to reduce the administrative burden related to the development of depreciation rates. However, the IURC believes that reduction of administrative costs must be tempered with the FCC's statutory obligation to prescribe

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reasonable and appropriate depreciation rates. Therefore, the IURC supports the implementation of the basic factor range option as described herein. We believe that the basic factor range option allows a good faith reduction in the administrative burden for both the carriers and the staff. Additionally, it continues to result in the matching of costs to the cost causer in a straightforward manner.

Furthermore, the IURC has **significant** reservations regarding the other options because of the lack of true-up mechanisms and the potential for future reserve imbalance amortizations; and the potential for price cap carriers to manipulate the depreciation expense to avoid their sharing obligation.

Wherefore, the Indiana Utility Regulatory Commission respectfully requests the FCC to adopt depreciation prescription rules consistent with the aforementioned comments.

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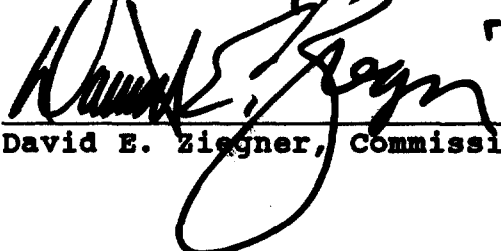
Respectfully submitted,


James R. Monk, Chairman


Frederick L. Corban, Commissioner


Vicky A. Bailey, Commissioner


G. Richard Klein, Commissioner


David E. Ziegner, Commissioner

ATTEST:


Ruth Ann Townsend, Commission Secretary

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Indianapolis, Indiana 46204
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